Institutional reform and state capacity in the South Pacific

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This article reviews the experience with reforms in Fiji and makes observations about the capacity of other Pacific states to develop and implement a regional reform agenda. Are extensive reform agendas in the Pacific prone to failure without better understanding of the capabilities of state institutions? In particular, there is little assessment of alternative approaches to policy implementation such as the capacity of local and indigenous institutions to guide the policy development and implementation process more effectively.[1]

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> In the South Pacific, the introduced institutions of the modern nation-state have always been overlaid on…a multiplicity of indigenous political structures. (Wainwright 2003:27)

Since independence, the economic performance of the Pacific island economies has lagged behind that of similar states in other parts of the world. These outcomes have occurred during periods of both high and low economic growth worldwide. They have occurred in spite of many of these nations following a range of economic policies that has succeeded in other low and middle-income nations. During this period, we have witnessed the rise and fall of ideas such as the development state, structural adjustment policies, the Washington Consensus and the post-Washington Consensus. Unfortunately, the outcome is a region that remains substantially dependent on relatively large transfers of foreign aid and remittances or where foreign countries actively manage their economies.

Since the early 1990s, the World Bank and the Asian Development Bank (ADB) have analysed the region's economies in various publications in attempting to explain the reasons for this weak growth. Despite these and other efforts to overcome the problem, the Pacific has been characterised as having poor prospects for change and has been given a label for its own malaise— 'the Pacific paradox'. There has not been an absence of ideas for reform in the region but there is a lack of sustainability in implementation. Part of this problem is the lack of internal demand for reform, as there has been a long-established compact between governments, local business and urban workers to retain the *status quo*. Furthermore, the lack of competition has reduced the need for these nations to cultivate their most important economic resource—their human capital.

Frustrated by weak national reform, the Pacific Plan represents another possible way of locking in regional commitments to implement and pursue reforms. It seeks to introduce a suite of options for regional approaches to national-level challenges. The options selected by Pacific Islands Forum countries will depend on the type and level of regional cooperation required. The creation of regionally based organisations is an option, but it is not the only available option. In a global economy in which competition for investment is intense, there is, however, a strong incentive to move to such regional arrangements.

The Pacific has been a laboratory for different economic ideas and this is the case with the Pacific Plan. This article explores the likelihood of success of these reforms. It begins with a review of economic growth in Pacific economies and notes that the region has been underperforming for a long time. It goes on to discuss the effect this will have on future living standards in the region. Next, it highlights the current path to development and puts it into an institutional context. Finally, the article examines the experience with reform in the Fijian civil service in an attempt to understand the reasons for its failure. Fiji is an appropriate country to draw on as an example: it is large enough to have a diversified economy, it has a large public sector and it has undergone periods of reform. After reviewing the weak record on national reform, this analysis concludes that the lack of capacity of local institutions makes change unlikely in order to adapt to this new regional platform for reform.

Reviewing economic growth

The economic performance of the Pacific island nations has been variable during the three decades of their independence. National growth and regional growth are compared with two other regions (the Caribbean and sub-Saharan Africa) to provide contrasts with other small island states and developing nations (Table 1). There has been an expectation that the Pacific would exhibit higher levels of economic growth and living standards, considering the scale of development assistance, the moderate levels of labour skills in most of the larger nations and the availability of capital. The lack of robust, sustained growth and the rapidly increasing populations have had adverse implications for living standards. There are rising levels of poverty in most of Melanesia and Nauru. Outcomes as measured by the United Nations' Human Development Index are disappointing (UNDP 2005). For example, in 2003, Fiji was ranked ninety-second in the world (keeping company with Sri Lanka and Turkey despite having a far higher gross domestic product per capita than Sri Lanka). The poor rates of growth reflect historical choices that have been made since independence but also some binding constraints (Sugden 2008) that have shaped the development process. In addition, particular factors such as military coups have slowed or impeded Fiji's economic progress. Overall, productivity growth has been weak and employment growth in most of the region has been unable to keep up with labour force growth and is often concentrated in the public sector. The Pacific region appears to have missed out on the strong world economy in the years 2002–07 and economic growth fluctuates significantly (Table 1).

The problem for developing nations is that weak growth can have implications that stretch over generations. The risk to the

Table 1 **Real economic growth in the Pacific, 2002–07** (percentage change per annum)

	2002	2003	2004	2005	2006	2007
Cook Islands	2.6	8.2	4.3	0.1	0.8	2.5
Fiji	3.2	1.0	5.3	0.7	3.4	–4.0
Federated States of Micronesia	1.4	3.3	–4.3	1.5	–0.7	1.0
Kiribati	2.7	–1.5	2.3	2.5	1.1	1.0
Nauru	0.1	–6.3	1.2	1.4	..	..
Palau	–3.5	–1.3	4.9	5.5	5.7	5.5
Papua New Guinea	–0.2	2.2	2.9	3.4	2.6	6.2
Marshall Islands	3.8	3.4	5.6	1.7	1.3	2.5
Samoa	1.0	3.1	3.4	5.2	2.6	3.1
Solomon Islands	–1.6	6.4	8.0	5.0	6.1	6.3
Tonga	3.0	3.2	1.4	2.3	0.7	–3.5
Tuvalu	5.5	4.0	4.0	2.0	3.0	2.5
Vanuatu	–7.4	3.2	5.5	6.5	7.2	6.6
The Pacific	0.4	1.8	3.6	2.6	2.6	3.2
The Caribbean	3.6	3.2	2.6	6.7	8.8	5.5
Sub-Saharan Africa	3.6	4.2	5.3	5.8	5.7	6.1

.. not available
Source: Australian Agency for International Development (AusAID), 2008. *Pacific Economic Survey 2008*, AusAID, Commonwealth of Australia, Canberra.

economy greatly increases if the population is growing rapidly and there is migration from rural areas to urban areas. The emergence of squatter settlements in Suva, Port Moresby and Honiara is testament to the fact that for large parts of the population living standards are worse than at independence and opportunities for future generations are likely to continue to worsen. Weak growth also affects a society's approach to wealth generation. Bowman (2005) suggests that weak growth might have encouraged the pursuit of 'rent seeking' and the spread of corrupt relationships between governments, bureaucrats and local businesses as they move from wealth creation to redistribution among family and ethnic groups.

One feature of the development experience of the Pacific is that government has played an important role in investment, running businesses and employing labour. Some observers have suggested that it appears that after more than two decades of weak growth, Pacific economies need less government regulation and should provide more opportunity to allow their version of a market economy to develop (for example, Duncan, Cuthbertson and Bosworth 1999). This, however, requires an institutional environment that is conducive to business, with government providing effective rule of law, a clear process of accountability for government departments and a low regulatory burden. There are some good island nation examples, such as Mauritius, and even locally, such as Samoa. The current development debate suggests that the choice is between whether this is done best by adopting successful structures from overseas and adapting them to local needs or by becoming part of a wider economic community to impose discipline externally. The latter might occur either economically by trade or politically by agreement to lower the costs of developing and maintaining supportive institutions. The current local structures appear to be insufficient, as Duncan and Gilling (2005) estimate that weak governance costs the region more than 2 per cent of its gross domestic product (GDP).

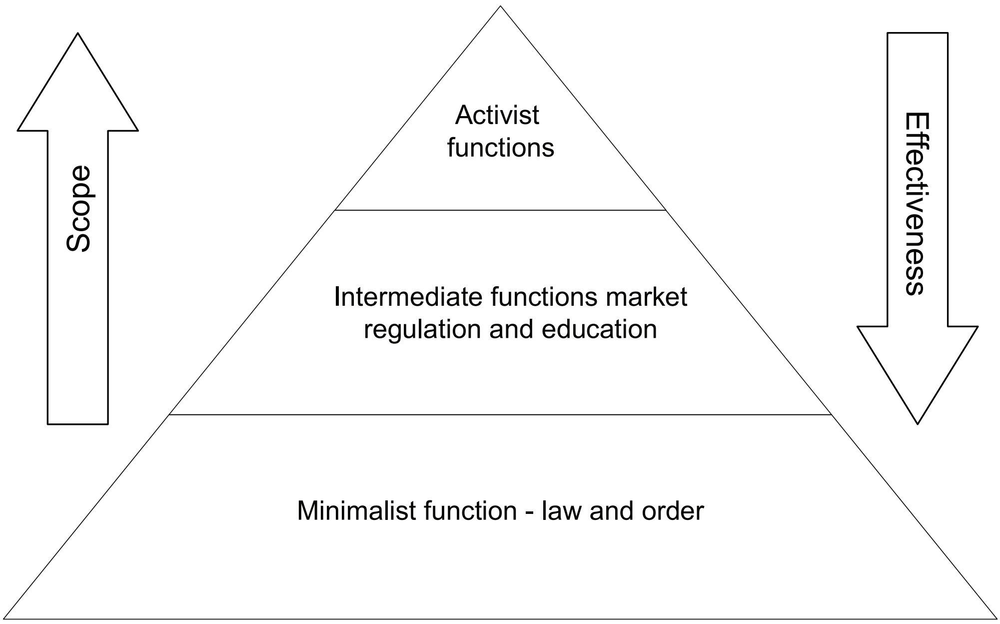
It has to be acknowledged that there are also physical and environmental limits to reform and integration and that the Pacific islands suffer from a range of disadvantages that creates additional developmental challenges: high transport costs, dependence on a narrow range of exports whose prices fluctuate substantially, isolation from major world markets, vulnerability to domestic conflict and natural disasters, and great cultural and linguistic diversity. These factors in combination weaken the State's authority to reach beyond the city limits. When they are combined with historical institutions that are inappropriate, over-extended public sectors and poor policy decision–making, some of the reasons why sustainable growth has been a problem become apparent (Figure 1). As the scope increases there is a need for additional capacity by the state but it becomes constrained by an absence of resources and skilled staff. As a result, the state becomes increasingly ineffective when attempting more complicated functions. With constrained resources and capabilities it is best to focus on the key tasks, such as law and order and providing basic services.

The role of institutions in growth

By reviewing and understanding the institutional structure of Pacific states, we can assess the lack of success of reform and low growth in the Pacific. The importance of ensuring the right sanctions, incentives and governance in the development process has considerable empirical support (Rodrik 2000, Easterly 2001). Emerging as a key part of the post-Washington Consensus, better governance enables the representation of the welfare, rights and interests of constituents, the creation and enforcement of policies and laws, the administration and delivery of programs and services, the management of natural, social and cultural resources, and negotiations between governments and other groups. For a nation that faces inefficiency generated by corruption and rent seeking, better governance is an important aspect of reform and increasingly is a key step in the reform process.

At the national level, there has been some delay in understanding its importance, but institutional reform has been at the centre of the Pacific Islands Forum Secretariat's agenda from the outset. Before the first Forum Economic Ministers' Meeting (FEMM) in 1997, the forum broadly concentrated on economic reform programs. Since then, there has been a refocusing on appropriate institutional frameworks as a prerequisite to successful economic reform—in particular, land rights and property rights. This shift in focus is reflected in the selection of issues/topics for discussions in subsequent FEMMs.[2] Policy issues canvassed have included accountability, land rights and economic regulation. A 2004 report to the FEMM found that all forum island countries accepted that appropriate institutional reform was a prerequisite to successful reform. Institutional reform in the forum island countries is, however, at

Figure 1 **Linking institutions and capacity**



Source: Adjusted by the author from Fukuyama, F., 2004. *State Building: governance and world order in the 21st century*, Cornell University Press, New York.

different stages; and implementation is very difficult, due partly to objections from traditional leaders as well as politicians.

In this article, institutions are defined in the broadest possible sense. They are considered to be a set of behavioural rules commonly observed by individuals in society. North (1990) defined institutions as formal and informal rules that determined the conduct of people in various areas of the economy. Feeny (1988) argues that they perform several important functions that include

- channelling information about market conditions, goods and participants
- defining and enforcing property rights and contracts; determining who gets what, how and when
- increasing or decreasing competition in markets through regulations, laws and codes.

There appears to be a move by many countries to a set of institutions that supports a business environment. Beeson (2003) argues that states are essentially rational and cooperate to reduce transaction costs. History, culture and geography, however, build up inertia to change and often create a set of guideposts that directs nations along a certain path of development. As rules for business and government take time to develop, it can be hard to change the underlying institutional settings as there are often large direct costs. While particular types of institutions might make a society less productive, cultural, historical and social factors act to reinforce each other, making change costly. Aron (2000) shows that there are considerable sunk costs in developing political and economic organisations that operate in a particular institutional environment. As a result, nations seek to use trade and regional integration arrangements to change local institutions.

There have been some notable examples of weak institutional structures in the Pacific region. For example, one of the key reasons for the poor development of agriculture (and its supporting commercial and industrial structure) in the Pacific has been the lack of commercial access to communal land arising from a poorly developed institutional structure for the purchase, sale, transfer and lease of land (Forum Secretariat 2001). It is, however, important to acknowledge that there are deep cultural links between land and Pacific peoples that affect the pace of institutional change of key institutions, such as the conventions associated with land ownership. The rest of this section explores the relationship between institutions and culture.

Bowles (1998) suggests that markets and other economic institutions do more than allocate goods and services; they also influence the evolution of values, tastes and personalities. Guiso, Sapienza and Zingales (2006) define culture as those customary beliefs and values that ethnic, religious and social groups transmit largely unchanged from generation to generation. Culture can affect people's expectations and preferences and these have a direct impact on economic outcomes. While the causality between institutions and culture runs both ways, it is generally considered that culture is a given, as it is often difficult to change country and faith and impossible to change ethnicity, race and family history. Landes (1998) emphasises the links from culture to beliefs and values to economic outcomes to support his notion that economically successful nations are driven by what he terms positive cultural factors. In particular, he contrasts the cultural factors that are associated with enterprise and innovation—thrift, hard work, tenacity, honesty and tolerance—with those that stifle it— xenophobia, religious intolerance, bureaucratic corruption and state edicts.

There are few measures of institutions in the Pacific or assessment of their linkages to cultural values. Concerns of non-governmental organisations such as Transparency International about corruption and lack of transparency and accountability in the region indicate, however, that cultural values might not be consistent with modern notions of governance. In the Pacific, there are many aspects that have shaped local cultural attitudes. Some of the local difficulties with neo-liberal thought might be traced to aspects of traditional Pacific economic systems. Schischka (2006) notes that the production of root crops has created a different kind of economic system to that in cultures dependent on rice or wheat. The local cultivation of root crops has led to villages being relatively self-sufficient in food—but these commodities often cannot be stored and this has reduced the opportunity to produce and build up surpluses or to undertake trade throughout the community or region.

These cultural traditions have had to work within a political and economic structure that was gifted at independence from colonial nations. Nearly all the nations in the region have European systems of government, laws, courts and constitutions inspired by liberal concepts of political and economic development. Since independence, there has been some attempt to shape the laws and the economy to local needs. After 20 to 30 years of independence, however, the outcome has been weak growth and a perception of weak or incompetent states. Increasingly, in this globalised environment, there is pressure for change and it is important to understand the role of institutions in that process. The inability of most Pacific states to meet the demands of modern forms of government might reflect a lack of local capacity to operate the structure and processes of the State that industrialised nations take as given.

A new path to development?

Under pressure from major donors dissatisfied with more than 30 years of variable performance and the ever-emerging pressure of movable populations and capital through globalisation, it appears that the Pacific island states are increasingly facing the prospect of either continuing to work individually and face harsher conditions on aid (or receive less aid) or establishing their own regional structure to improve their negotiating position for trade and aid and mutually support each other's reforms and development. The Pacific Plan represents a new approach to regional development. The plan brings together about nine million people, in an area that is spread across the Pacific. It builds on the cultural, trade and investment agreements that have developed within the region. It covers the four pillars of economic growth, sustainable development, good governance and security. Robertson (2005) describes the agreement as involving

- regional cooperation—involving political agreements and increased sporting and cultural linkages
- regional provision of public services by pooling various national education and regulatory agencies, such as the Forum Fisheries Agency
- regional integration, increasing trade and investment linkages through reducing barriers to the movement of goods, services and people.

The Pacific nations' move to regionalism is a reaction to the emerging issues related to global trade and investment liberalisation and the consequences of civil strife facing several Pacific states. At the economic level, there appear to be few strong reasons for the reforms since most nations have a primary trade relationship with a combination of Australia, New Zealand, the United States and/or Japan. At the regional level, trade reform has been delayed by a succession of trade disputes among several Pacific states that have attempted to protect their own narrow manufacturing base from other states. In trade terms, there are few gains to be generated from trading with nations that have the same type of exports or that export goods more expensively than other markets. Collier (2007) argues that regional trade agreements among poor countries are damaging, leading to accelerating divergence in living standards from global trends and trade diversion.

It is more plausible to see the Pacific Plan as a political agreement and something that is favoured by regional donors in response to the variable record of more than a decade of individual reform. For example, many nations do not lack good ideas about how to fix their problems. While the range of reviews, reports and analysis is extensive, however, few positive outcomes have emerged. The forum economic ministers have been making statements about reform and accountability for more than 10 years. The Pacific Plan reflects an attempt to redress what has been absent in previous reform attempts—political will to support changes and capacity to implement them.

The role of capacity: reform in Fiji

This section provides an overview of public sector reform in Fiji in order to understand the difficulties it has faced in sustaining reform. On independence, Fiji inherited a public sector from the colonial government. The public sector in Fiji is large, thus absorbing a hefty proportion of government expenditure and important elements of the small, skilled workforce. The total budget expenditure in 2002 as a percentage of GDP was 36 per cent (although it has fallen since), but budget deficits remain a common feature. In addition, several key business inputs (such as water and electricity) are government-owned corporations or departments. Most of the public sector-owned enterprises have been making very low or, in several cases, negative rates of returns. The fiscal drain that this has placed on the economy has been increasingly recognised since the 1990s and identified by the World Bank, the ADB and other donors in numerous reports. The Fijian government has made several attempts to reform the public service and public enterprises in the past 15 years, with differing levels of effectiveness and enthusiasm. For example, the Chaudhry Government of 2000 announced it was committed to reform but made a series of policy reversals (such as the reversal of the reform of the Airports of Fiji Limited) that indicated it was unwilling to undertake significant public sector reform.

Reddy, Prasad, Sharma, Vosikata and Duncan (2004) suggest that this situation has arisen for various reasons. Fijian governments in the 1970s and 1980s used government enterprises and departments as active partners in development. Using the government's monopoly in a range of key business inputs, the aim was to ensure that local businesses were able to expand. Overall, there was a general suspicion of private enterprise and the adverse impact that freer trade with industrialised nations would have on local industries. World events, however, led to a change in policy. From the mid 1980s onwards, there was a wider move in industrialised nations to 'roll back' government.

Since the slowdown in world growth after the recessions of the 1980s, it has been a challenge to successive Fijian governments to adopt good macroeconomic policies while maintaining a large amount of microeconomic control over the economy. In addition, as economic problems began to emerge, there was increasing realisation that good policies meant little if there was no effective public sector to implement and enforce them. The capacity of the public service steadily worsened after the 1987 coup, when there was a move away from promoting people in the public sector on merit and an absence of principles of transparency and good management in government payments to support indigenous groups and businesses. Despite the lack of interest in reform in the early 1990s, mounting deficits and the collapse of the National Bank of Fiji led to reforms being implemented. The reform process, however, was confused, as there was inadequate preparation of legislation for the different stages of public sector reform such as the development of a financial and governance framework. This was compounded by the lack of staff experienced in public sector reform to draft the required legislation and regulations for successful implementation.

Overall, the reform experience in Fiji has been variable. Some of the problems relate to a lack of capacity as existing government structures have impeded political and economic development and nation building. Considering the problems that have occurred with reform in the public sector, there is some question about the extent to which top-down reform has been appropriate for Fiji. The delay in reform can be traced to inadequate capacity to undertake the required reforms in the early period, which later moved to resistance from vested interests within government and also from interests outside government that enjoyed the rents arising from the system. This resistance has been exacerbated by the absence of clear government leadership and determination to follow through with reforms. It appears that Fiji does not have the capacity to face different types of challenges, to persevere in a certain direction of change against setbacks and opposition or to detect flaws in a given institutional architecture and fix them. The lesson from this example is that without an understanding of local capacity constraints, regional-level reform might lead to similar mistakes being made. As Fukuda-Parr, Lopes and Malik (2002) suggest, capacity building needs to be addressed at the individual, institutional and society levels.

What stops better policy being adopted? The role of capacity in reform

> [U]ntil we realize that we are choosing between social arrangements that are more or less all failures, we are not likely to make much headway (Coase 1964:195).

Ruis and van de Walle (2003) consider state capacity to refer to the ability of state agencies to conceive, design, undertake and evaluate economic policies. The growth of institutional thought has provided an opportunity for a reconsideration of the role that social norms play in the development of community relationships and their linkage to development. Aoki (2001) highlights the role of community norms as an institutional device to promote and sustain cooperation in the community to facilitate and/or deter the transition to a market economy. Thus, without a clear understanding of the role and importance of local institutions and local state capacity there is a strong possibility that reforms at the national or international level will continue to falter, highlighting, in essence, the importance of institutional reform.

Underdeveloped state capacity, coupled with poorly utilised institutions and a small base of human capital, means that a state cannot create a firm foundation for the complex and wide-ranging reforms required to be a part of the global economy. While building capacity has been a central plank of the aid effort by many nations, it has to be more than just training and education focused on the public sector. Fukuyama (2004) suggests that private sectors must be strengthened to enable them to lead the demand for change. In the case of Fiji, we find that government effectiveness, as measured by the University of the South Pacific, has changed little in the past 10 years (Gani and Duncan 2007).

Weak institutional and economic structures have led Pacific island states—like other fragile states—to be dependent on small political and business elites that have effectively captured the levers of state power and use these positions to enrich themselves and reward their support bases, who are usually members of their own community or language group. This has created an environment in which corruption has developed. An inability to deal with corruption has been the real failure in the region. Opportunity has been provided by arbitrary action by government to support particular groups via special tariffs, exemptions, incentives and preferences for government contracts. Application of standards in an ad hoc fashion encourages corruption that severely damages growth prospects and labour force development. Combined with poor fiscal expenditure guidelines, weak management and inadequate skills, an atmosphere develops in which connections to particular people become important and payments made to certain individuals reduce the administrative burden but distort economic activity and create incentives for further corruption (World Bank 2001).

Can Pacific-wide reform make a difference?

> [T]he spread of economic globalization brings great potential benefits—but only if countries can develop strong and resilient institutions, and maintain present economic policies (Downer 2004).

The Pacific Plan has been hailed as an important means to support forum island countries in overcoming their structural challenges through various regional arrangements and, in some cases, capacity supplementation. The task, however, is large. In particular, adapting some of the work by Collier (2007), we can identify several key state-capacity issues. For example, the existence of local conflict within nations remains in Solomon Islands, Papua New Guinea and Fiji. Transport and communication linkages remain weak or in the hands of local monopolies, and several countries have mismanaged their natural resources.

These factors bring into focus the absence of the will to reform in these countries. It has not been a matter of starting reform but more that it rarely is seen through and completed. In addition, it is easier for foreign governments and multinational agencies to wait for the local conditions to deteriorate and then begin new programs than to change and adapt to the local conditions. In many countries, there is a strong culture of rent seeking that aims to delay reform. There is a long history of patronage, rent seeking and pork-barrelling to obtain and maintain political support. As a result, the longer the absence of will, the faster the capacity to implement and support reform in the public sector will decline. Overall, as Ruis and van de Walle (2003) observe of the reform experience in other low-income states, reform is likely to be undermined by problems of local ownership and poor implementation. Similarly, any benefit from reform has to be defended from sectional interests that will seek to control any additional income and investment opportunities.

The experience in Fiji has shown that reform either by decree or ministerial statement does not occur if there is no bureaucratic capacity to follow through with the implementation of the proposed changes. Even the supposed advantage of authoritarian leaders fails in the face of incapacity. The reformist optimism of the Pacific Plan therefore requires a serious review and understanding of the local public service and its levels of skill and capacity. In Fiji, the failure of the first phase of public sector reform was due partly to an absence of skilled staff to understand the legislative requirements and changes in budgetary and financial regulations required by government. In addition, there was an absence of accounting and managerial expertise needed by boards for successful corporatisation and privatisation.

Other key lessons and messages drawn from the FEMM report (Pacific Islands Forum Secretariat 2004), which reaffirm the importance of institutional change for economic reforms, include

- the importance of strengthening civil society to ensure transparency and accountability
- the key role played by institutional structures with respect to rights to land
- the fact that all such change is not without transaction costs, which might be reduced by gradual adjustment and by approaching reform on a case-by-case basis
- the fact that institutions go far beyond the direct economic ones—economic change requires broad institutional change and the implications need to be transparent; thus institutional reform

must be transparent and accountable and easily understood by the people

- accepting that there is potential for major conflicts of interest between stakeholders over the creation of new institutions that disrupt the status quo, such as traditional leaders (in Fiji, Samoa and Tonga) and landowners (in Fiji, Solomon Islands and Papua New Guinea), and developing strategies to address these potential conflicts
- broadly, with respect to issues of landholding, the challenge for Pacific island governments is in structuring the land-access system so as to balance the needs of the modern economy with the traditional demands of society.

Conclusion

The importance of state capacity to reform program outcomes has long been underestimated by the designers of policy reform programs. North (1993) suggests that successful economic growth is the story of the evolution of more complex institutions, composed of rules—the norms of behaviour—and the way they are enforced. These institutions create the forms of cooperative relations necessary for businesses and individuals to trade and participate in economic activity with confidence. Thus, without an understanding of the development of institutions and their role in better outcomes, there will be inadequate outcomes and an absence of support for the reform process.

Without change to existing institutions there is little likelihood that the Pacific islands will be able to overcome historical practices and, in particular, challenges such as limited market access arrangements, political instability, deteriorating security situations, poor macroeconomic management, poor governance, poor infrastructure, limited access to land and slow and/or intermittent public sector reforms. If there is no new paradigm for national institutions, academics and bureaucrats will be examining the status of the Pacific in another 10 years and wondering what new approach to reform should be taken.

Notes

1 An earlier version of this paper was presented at the PIPSA conference, December 2007, Port Vila, Vanuatu.

2 A list of issues/topics considered at the annual FEMM can be accessed via the following link: http://www.forumsec.org/pages.cfm/economic-growth/economic-growth-work-programme-1/forum-economic-ministers-meeting-femm-1/.

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